

H-3103-1 - FEES, RENTALS, AND ROYALTY

KeywordsIII. Minimum RoyaltyA. General

Section 17(d) of the MLA, as amended, provides that a minimum royalty in lieu of rental shall be paid at the end of each lease year beginning on or after a discovery of oil or gas in paying quantities. For example, if a lease issued effective May 1, 1991, is determined on May 26, 1995, to have a discovery of oil or gas in paying quantities (the annual rental having been timely paid for the lease year beginning May 1, 1995), the minimum royalty payment to the MMS is due for the next lease year by April 30, 1997. Minimum royalty and annual rental are not paid for the same lease year.

MINIMUM
ROYALTY

This minimum royalty provision is applicable to all leases issued on or after August 8, 1946, and to earlier-issued leases if the lessee has elected to be governed by the provisions of this Act. Section 15 of the Act of August 8, 1946, authorizes any person holding a lease on the effective date of the Act to elect to have the lease governed by the applicable provisions of the Act instead of the law previously in effect. Accordingly, not all existing oil and gas leases are subject to the minimum royalty provisions of Section 17(d) of the MLA. Therefore, the individual lease form and the rental and royalty rate schedule that may be attached to the lease form (for older leases) must be reviewed in each case.

ELECTION UNDER
SECTION 15 OF
1946 ACT

Some lessees and/or operators of pre-1946 Act leases have been under the assumption that their leases were subject to minimum royalty in lieu of rentals, i.e., that an election to come under Section 15 of the 1946 Act had been filed when, in fact, such an election has never been filed. Therefore, if a lessee now files such an election, the State Office (SO) Lease Adjudication is to take no formal action to approve it, but is to provide a copy to the MMS (or receive a copy that was filed directly with the MMS), and ensure that a copy of the election is placed in the lease case file. For the ALMRS Entry, the appropriate royalty rate action code or Action Code 649 - LEASE PAYING MIN RLTY is to be cross-referenced in the Action or General Remarks with the statement that "Section 15, 8/8/46 Act election filed (MM/DD/YY)."

SECTION 15
ELECTION TO
BE FILED IN
LEASE CASE
FILE

AUTOMATED
NOTATION -
ELECTION UNDER
1946 ACT

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Keywords

For leases issued in accordance with the law and regulations that were in effect prior the Reform Act, a minimum royalty rate of \$1 per acre or fraction thereof in lieu of rental is required.

MINIMUM
ROYALTY RATE
LEASES BEFORE
REFORM ACT

Leases issued in accordance with the Reform Act of December 22, 1987, require a minimum royalty rate of not less than the rental rate that otherwise would be required for that lease year. Therefore, the minimum royalty rate is \$1.50 per acre or fraction thereof for the first through fifth lease years and \$2 per acre or fraction thereof for each lease year thereafter. These minimum royalty rates also apply to oil and gas right-of-way leases issued under the Act of May 21, 1930, when such leases are issued on or after the June 17, 1988, regulations. The minimum royalty rate for exchange and renewal leases issued since the Reform Act is \$2 per acre or fraction thereof.

MINIMUM
ROYALTY RATE
REFORM ACT
LEASES

The account for any lease in a minimum royalty status is maintained by the MMS.

See Appendix 2 for a brief listing of decisions addressing oil and gas lease minimum royalty issues.

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KeywordsB. Application of Minimum Royalty

The following items define general minimum royalty provisions and outline the required procedures. Certain exceptions to these general provisions are discussed in Section III.C, below. Generally, these exceptions deal with situations where a currently nonproducing lease is extended by other provisions of the law and regulations or where lands are severed from those having a minimum royalty.

MINIMUM
ROYALTY RATE
PROVISIONS

1. The anniversary date of a lease is the anniversary of its effective date (ALMRS Entry: DE 1775 Action Code 225/DE 2910 Action Code 868). The lease year is defined as a 12-month period beginning at midnight immediately preceding the anniversary date (e.g., the midnight that begins the day of May 1, 1995) and ending at midnight on the last day prior to the next anniversary date (e.g., the midnight that ends the day of April 30, 1996). Minimum royalty accrues beginning from the anniversary date of a lease but is not payable until the end of the lease year.

2. Minimum royalty accrues as a debt to the U.S. in lieu of rental beginning from the first anniversary date of the lease on or after the initial discovery of oil or gas in paying quantities, i.e., the completion of a well capable of producing oil or gas in paying quantities on the leasehold or the allocation of production to the leasehold. On unitized lands, minimum royalty accrues only on the acreage that participates in the unitized production. The nonparticipating acreage is subject to rental, unless this acreage also contains or has contained a well capable of producing oil or gas in paying quantities. On a lease that is subject to a communitization agreement (CA), the entire lease becomes subject to minimum royalty.

MINIMUM ROYALTY
ACCRUES AFTER
DISCOVERY

PARTICIPATING
ACREAGE

NONPARTICIPATING
ACREAGE

COMMUNITIZED
LEASE

3. Actual royalty accruing from a lease or allocated to a unitized or communitized lease during the lease year is credited against the minimum royalty obligation for that lease year. If the royalty from production does not equal or exceed the required minimum royalty for the lease year, the lessee is obligated to pay the difference. For example, if the minimum royalty obligation for a 640-acre lease is \$1,280 (\$2 per acre), and the royalty from production is only \$1,200, the difference of \$80 must be paid to the MMS.

ACTUAL ROYALTY
CREDITED AGAINST
MINIMUM ROYALTY

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Keywords

4. Once a lease converts to a minimum royalty status, it generally does not revert to a rental status during its original or fixed term. Some exceptions are discussed in Section III.C, below.

REVERSION TO
RENTAL STATUS

5. Once effective, minimum royalty is a minimum amount unconditionally payable for the remainder of the lease year and is not subject to proration; i.e., if a productive lease becomes nonproductive, terminates, or acreage is relinquished during the lease year, the minimum royalty will not be reduced or prorated. For example, if a lease contained 640 acres at the beginning of the lease year (on the anniversary date) and 320 acres is relinquished later in the lease year, a minimum royalty of \$960 (at \$1.50 per acre) is owed for the entire lease year.

MINIMUM ROYALTY
NOT SUBJECT TO
PRORATION

6. The rental, royalty, and minimum royalty provisions of oil and gas leases issued under the various amendments to the MLA differ, and each lease must be reviewed independently to determine the appropriate requirements. The minimum royalty rate is not affected by lease reinstatements.

MINIMUM ROYALTY
NOT AFFECTED
BY LEASE
REINSTATEMENTS

7. Since minimum royalty is an obligation accruing from the beginning of the lease year and is based on the acreage embraced in the lease at that time, any segregation of the lease during the lease year, whether by partial assignment or unitization, will not change this total obligation. Thus, for the lease year in which such a segregation is effected, the minimum royalty is to be determined based on the total acreage in the lease at the beginning of the lease year (on the anniversary date), and all production royalties from that acreage are to be credited against that obligation. (See also Section III.C, below.)

MINIMUM ROYALTY
DUE ON ENTIRE
LEASE ACREAGE
DESPITE LEASE
SEGREGATION
DURING LEASE
YEAR

8. Compensatory royalty payments may be applied to any minimum royalty obligation that exists on the lease. However, the payment of compensatory royalty will not, by itself, cause a lease to convert to a minimum royalty status.

COMPENSATORY
ROYALTY MAY BE
APPLIED TO
MINIMUM ROYALTY

9. When a compensation due the United States is based on the full value of gas lost, such payment may be credited against the minimum royalty obligation.

COMPENSATION
FOR VALUE OF
GAS LOST

10. Rental, injection, withdrawal, and other charges under a gas storage agreement cannot be applied to any minimum royalty obligation that exists on the lease.

GAS STORAGE
AGREEMENT CHARGES
NOT APPLIED TO
MINIMUM ROYALTY

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C. Effect of Lease Segregation on Minimum RoyaltyKeywords

A lease may be segregated into two or more separate leases either by partial assignment or by part of the lease being committed to a Federally approved unit. Partial commitment to a CA does not cause lease segregation. However, minimum royalty accrues as a debt due from the beginning of the lease year that is payable at the end of the lease year and is not reduced or increased by the subsequent segregation occurrences during that lease year, as discussed in Section III.B.7, above.

EFFECT OF LEASE
SEGREGATION ON
MINIMUM ROYALTY
OBLIGATION

For a lease segregated by a partial assignment, the assignor remains liable for the minimum royalty obligation on the assigned portion should the assignee fail or refuse to pay. The lease containing the well remains on minimum royalty. However, the lease without the productive well reverts to a rental status on the next lease anniversary date (which is the same as that for the original or parent lease). In such instances, the SO Lease Adjudication is to notify the lessee of the nonproductive lease that the lease is reverting to a rental status and that failure to pay such rental on or before the lease anniversary date, or within 30 days of receipt of the notice, will subject the lease to automatic termination. (See Section V.A, below.) Accordingly, for leases segregated by either partial assignment or unitization, the minimum royalty must be determined on the total acreage in the lease at the beginning of the lease year. All production royalties attributable to that acreage are to be credited against that obligation.

PARTIAL
ASSIGNMENTS

Although no longer an allowable policy, if in earlier years an oil and gas lease has been segregated horizontally by unitizing specific formations only, the holder of each such segregated lease is liable for the payment of rental or minimum royalty based on the entire acreage in such segregated lease even though this would result in multiple payments for the same lands.

HORIZONTAL
SEGREGATIONS

Once a minimum royalty obligation accrues, it cannot be subsequently reduced or prorated. This provision applies even though the lease is relinquished, canceled, or terminated on the day following the anniversary date (see Solicitor's Opinion M-36405, dated June 13, 1957).

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